

**STATE OF ALABAMA  
DEPARTMENT OF INSURANCE  
MONTGOMERY, ALABAMA**

REPORT ON EXAMINATION

OF

**ALFA INSURANCE CORPORATION**

**Montgomery, Alabama**

AS OF

DECEMBER 31, 2006

Participation:

ALABAMA  
Southeastern Zone, NAIC

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**AFFIDAVIT**

**STATE OF ALABAMA  
COUNTY OF MONTGOMERY**

Blase Francis Abreo, being first duly sworn, upon his oath deposes and says:

THAT he is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

THAT an examination was made of the affairs and financial condition of *ALFA INSURANCE CORPORATION* for the period of January 1, 2002 through December 31, 2006;

THAT the following 42 pages constitute the report therein to the Commissioner of Insurance of the State of Alabama; and

THAT the statements, exhibits, and data therein contained are true and correct to the best of his knowledge and belief.

Francis Blase Abreo

Blase Francis Abreo, CFE

Subscribed and sworn to before the undersigned authority this 23<sup>rd</sup> day of May 2008.

Dianne B. Mills

(Signature of Notary Public)

Dianne B. Mills

(Print Name)

Notary Public

in and for the State of Alabama

My Commission expires 4-18-2009



**BOB RILEY**  
GOVERNOR

**STATE OF ALABAMA**  
**DEPARTMENT OF INSURANCE**

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Montgomery, Alabama  
May 23, 2008

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Honorable Walter A. Bell  
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Dear Commissioners and Directors:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, a full scope financial and market conduct examination as of December 31, 2006, has been made of

**ALFA INSURANCE CORPORATION**

at its home office at 2108 East South Boulevard, Montgomery, Alabama, 36116. The report of examination is submitted herewith. Where the description "Company" appears herein, without qualification, it will be understood to indicate Alfa Insurance Corporation.

## SCOPE OF EXAMINATION

A full scope financial and market conduct examination was authorized pursuant to the instructions of the Alabama Insurance Commissioner and in accordance with the statutory requirements of the *Alabama Insurance Code* and the regulations and bulletins of the State of Alabama Department of Insurance in accordance with the applicable guidelines and procedures promulgated by the National Association of Insurance Commissioners (NAIC); and in accordance with generally accepted examination standards.

The Company was last examined for the five-year period ended December 31, 2001. A limited scope examination for the period ended December 31, 2004, concluded on June 30, 2005. The current examination covers the intervening period from January 1, 2002, through December 31, 2006, and was conducted by examiners from the Alabama Department of Insurance. Where deemed appropriate, transactions subsequent to December 31, 2006, were reviewed.

The examination included a general review of the Company's operations, administrative practices, and compliance with statutes and regulations. Corporate records were inspected. Income and disbursement items for selected periods were tested. Assets were verified and valued, and all known liabilities were established or estimated as of December 31, 2006. However, the discussion of assets and liabilities contained in this report has been confined to those items which resulted in a change to the financial statements, or which indicated a violation of the *Alabama Insurance Code* and the Insurance Department's rules and regulations, or other insurance laws or rules, or which were deemed by the examiner to require comments and/or recommendations.

Company office copies of the filed Annual Statements for the years 2002 through 2006 were compared with or reconciled to account balances with respect to ledger items.

The market conduct phase of the examination consisted of a review of the Company's territory, plan of operation, complaint handling, marketing and sales, producer licensing, policyholder service, underwriting and rating, claims payments and practices, and compliance with privacy policies and practices.

A signed certificate of representation was obtained during the course of the examination. In this certificate, management attests to have valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2006. A signed letter of representation was also obtained at the conclusion of the examination whereby management represented that, through the date of this examination report, complete disclosure was made to the examiners regarding asset and liability valuation, the financial position of the Company, and contingent liabilities.

## ORGANIZATION AND HISTORY

The Company was incorporated March 11, 1955, as a mutual insurance company, under the name, American Service Mutual Insurance Company.

In December of 1977, Alabama Farm Bureau Mutual Casualty Insurance Company, (currently Alfa Mutual Insurance Company (AMI)) obtained control of the Company pursuant to an agreement whereby AMI acquired the Company's outstanding surplus notes, all directors of the Company resigned, and new directors designated by AMI were elected.

Effective August 31, 1982, the Company was converted to a stock insurance company. Its certificate of authority was amended to authorize 3,000,000 shares of common stock at a par value of \$1.00 per share. The initial capitalization was effected by the sale of 500,000 shares of its common stock for \$2.50 per share, to Federated Guaranty Life Insurance Company (currently Alfa Life Insurance Corporation [ALI]). The sale resulted in \$500,000 of paid up capital and \$746,683 of paid in surplus (\$3,317 was expended in costs of asset transfers). The name of the Company was changed to Federated Guaranty Insurance Company.

On January 4, 1983, the holding company now named Alfa Corporation was incorporated in Delaware under the name, Federated Guaranty Corporation. At that time, the stock of the Company, as well as that of its parent, ALI, was contributed to Alfa Corporation.

Effective May 1, 1987, the Alabama Farm Bureau Federation withdrew from the national Farm Bureau Federation, of which it was a franchise member, and changed its name to Alabama Farmers Federation. The name of the Company was changed to Alfa Insurance Corporation.

During the interim from the Company's organization through 1987, the Company became affiliated with four other property and casualty insurers. In 1987, a reinsurance pooling agreement was formed between these five affiliates. The terms of the agreement provide that all direct business of the affiliates will be ceded to AMI. The pooled business is then retro ceded according to percentages provided in the pooling agreement. In 1989, an intercompany reinsurance pooling committee, representing the boards of directors of the reinsurance pool participants, was established. This committee is responsible for reviewing and approving any changes to the pooling agreement, to assure that transactions are fair and equitable to all pool participants, and to monitor potential, or actual, conflicts of interest between pool participants.

In 1999, Alfa Specialty Insurance Corporation (ASI) was organized as a stock company, wholly-owned by AMI. ASI became a participant in the reinsurance pooling agreement in 2001.

In 2004, Alfa Vision Insurance Corporation (AVI) was organized as a wholly-owned subsidiary of Alfa Corporation, an SEC registrant. Alfa Corporation is affiliated with Alfa Mutual Insurance Company, Alfa Mutual Fire Insurance Company, and Alfa Mutual General Insurance Company (collectively, the Mutual Group). The Mutual Group owns 54.8% of Alfa Corporation's common stock, their largest single investment. (See the heading SUBSEQUENT EVENTS for development on Alfa Corporation). AVI commenced business on January 1, 2005, and became a participant in the reinsurance pooling agreement effective January 1, 2005.

During the period covered by the examination, the Company amended the Articles of Incorporation by revoking and replacing Article III, Paragraph 16, which was effective February 24, 2003. No amendments were made to the Company's *By-Laws* during the period under examination.

Numerous increases were made to the Company's capital structure between 1982 and 1994. The last such change occurred on December 31, 1994. Paid-up capital was increased to \$1,500,000, consisting of 1,500,000 shares of \$1.00 par value common stock issued and outstanding. The 2006 Annual Statement indicated the following:

- Net Admitted Assets: \$449,894,007
- Liabilities: \$250,166,662
- Total capital and surplus:
  - Common capital stock: \$1,500,000
  - Gross paid in and contributed surplus: \$32,447,957
  - Aggregate write-ins for other special funds: \$3,775,279
  - Unassigned funds (surplus): \$162,004,109

## MANAGEMENT AND CONTROL

### Stockholders

The Company is a stock corporation with ultimate control vested in its stockholders. At December 31, 2006, one hundred percent (100%) of the issued and outstanding common stock was owned by Alfa Corporation, an SEC registrant. The controlling interest in Alfa Corporation is held by Alfa Mutual Insurance Company, Alfa Mutual Fire Insurance Company, and Alfa Mutual General Insurance Company (collectively, Alfa Mutual Group). Alfa Mutual Group owns 54.9% of Alfa Corporation, and the remaining 45.1% is publicly held.

### **Board of Directors**

The *By-Laws* of the Company provided that the business and affairs of the Corporation shall be managed by its Board of Directors. ARTICLE 3, Section 1 of the *By-Laws* set the number of directors at "... consisting of eight (8) persons, who shall be elected at the annual meeting of stockholders for a term of one year. ..."

The following directors were elected by the stockholders and were serving at December 31, 2006.

<b><u>Name and Residence</u></b>	<b><u>Principal Occupation</u></b>
Jerry Allen Newby Athens, Alabama	Chairman of the Board, CEO, President, Alfa Mutual Insurance Company
Russell Riley Wiggins Andalusia, Alabama	Vice President, Southeast Area, Alfa Mutual Insurance Company
Stephen Leonard Dunn Evergreen, Alabama	Treasurer, Alfa Mutual Insurance
Curtis Dean Wysner Woodland, Alabama	Vice President, Central Area, Alfa Mutual Insurance Company
Benjamin Phil Richardson Montgomery, Alabama	Retired, Company Executive Vice President
Hal Franklin Lee Hartselle, Alabama	Vice President, Northwest Area, Alfa Mutual Insurance Corporation
Jacob Calhoun Harper Camden, Alabama	Vice President, Southwest Area, Alfa Mutual Insurance Company
John Russell Thomas Alexander City, Alabama	President, Aliant National Corporation

### **Officers**

ARTICLE 4, SECTION 1 of the *By-Laws* states: "THE OFFICERS OF THE CORPORATION shall consist of a Chairman of the Board, President, one or more Vice Presidents, Secretary, and Treasurer, who shall be elected for one year by the Board of Directors at its annual meeting after the annual meeting of stockholders. ..."

The following officers were elected by the Board of Directors and were serving at December 31, 2006.

Officer	Title
Jerry Allen Newby	President and CEO; Chairman of the Board
Clyde Lee Ellis III	Vice President and Treasurer
Herman Alan Scott	Secretary

The following were appointed officers at December 31, 2006:

Officer	Title
Clyde Lee Ellis III	Executive Vice President, Operations
Herman Tyrone Watts	Executive Vice President, Marketing
Stephen Goddard Rutledge	Senior Vice President, CFO & Chief Investment Officer
Herman Alan Scott	Senior Vice President and General Counsel
James Alan Azar	Senior Vice President, Audit & Risk Management
John Thomas Jung	Senior Vice President, Chief Information Officer
Jerry William Johnson	Senior Vice President, Claims
Thomas Earle Bryant	Senior Vice President, Human Resources
Wyman Worley Cabaniss	Senior Vice President, P & C Underwriting
Carol Lynn Golsan	Senior Vice President, Marketing Services
Alfred Edwin Schellhorn	Vice President, Corporate Development
Gordon Thomas Carter	Vice President and Associate General Counsel
Darrell Lee McNeal	Vice President, Georgia Marketing
Robert Wyatt Pace	Vice President, Mississippi Marketing
Linda Gail Pelt	Vice President, Auto Underwriting
Kenneth Everett Stephens	Vice President, P & C Systems Implementation
Elizabeth Vail Chancey	Vice President, Property & Casualty Underwriting
Ralph Clayton Forsythe	Vice President, Finance & Assistant CFO
David Ray Proctor	Vice President, Taxes
Donald Eugene Manis	Vice President, Property & Casualty Actuary
Christine Gnann Cantrell	Vice President, Marketing Communications
Connie Leah Whitecotton	Vice President, Chief Risk & Compliance Officer
Jacob Daniel Black	Vice President, P&C Accounting
Patti Jo Everage	Vice President, Financial Reporting & Planning
Thomas Allen Foster	Vice President, Loan Operations
Russell John Sinco	Vice President, Projects, Finance
Julie Meadows Parish	Assistant Vice President, Financial Reporting Compliance
John Delane Hemmings Jr.	Vice President, Investments

## Committees

The following committees were appointed by the Board of Directors and were serving at December 31, 2006:

<u>Executive Committee</u>	
Jerry Allen Newby	Curtis Dean Wysner
Hal Franklin Lee	Jacob Calhoun Harper
Russell Riley Wiggins	Stephen Leonard Dunn
<u>Compensation Committee</u>	
Hal Franklin Lee	Jacob Calhoun Harper
Russell Riley Wiggins	Stephen Leonard Dunn
Curtis Dean Wysner	Jerry Allen Newby
<u>Pooling Committee</u>	
Jerry Allen Newby	Benjamin Phil Richardson
John Russell Thomas	
<u>Contribution Committee</u>	
Hal Franklin Lee	Russell Riley Wiggins
Jacob Calhoun Harper	Curtis Dean Wysner
Stephen Leonard Dunn	

## Conflict of Interest

The Company follows an established procedure for the disclosure of conflicts between the Company's interest and the personal interest of directors and officers. The conflict of interest policy is part of the "Principles of Business Conduct" (Principles) policy, which was effective August 14, 2001. Effective, February 4, 2003, the Principles underwent major revisions, when the Company incorporated the provisions required by the Federal Sarbanes-Oxley Act.

Section 8 of the revised Principles, does not require the employees to sign annual conflict of interest statements. Under the policy, all new employees are required to confirm their compliance with the policy at their hiring. Confirmations are obtained from all existing employees when the policy undergoes significant revision, or whenever circumstances dictate that reconfirmation would be helpful in reinforcing the Company's "tone at the top" message.

The listing that indicated that the officers and directors had read the Principles and electronically acknowledged that they had read the Principles was reviewed. The disclosures

made during the period did not appear to represent a conflict of interest. The listing was checked with the names of the officers and directors listed on the Company's Annual Statements under examination. The review indicated that some directors and some elected officers, all of which were non-employees, had not acknowledged reading the Principles, since it had a significant revision, effective February 4, 2003. Company management indicated that the aforementioned directors and elected officers had signed the acknowledgement, confirming reading and adhering to the Principles, since its significant revision. However, according to Company management, the signed copies had been misplaced and could not be located.

The Company indicated "Yes" to the GENERAL INTERROGATORIES of the NAIC Annual Statement Instructions, which asks the following question:

"Has the reporting entity an established procedure for disclosure to its board of directors or trustees of any material interest or affiliation on the part of any of its officer, directors, trustees, or responsible employees that is in conflict or likely to conflict with the official duties of such persons?"

As noted above, the Company had an established procedure for the disclosure of conflicts of interest to the Board of Directors; however, the Company could not provide evidence that all directors had signed the conflict of interest statements.

## **CORPORATE RECORDS**

The Articles of Incorporation, and *By-Laws*, as amended were inspected and found to provide for the operation of the Company in accordance with usual corporate and applicable statutes and regulations. One amendment was made to the Articles of Incorporation during the period covered by the examination.

Minutes of the Annual Membership meetings, Board of Directors and committees of the Company, from January 1, 2002, through the most recent meetings recorded at the time of examination, were reviewed. The minutes appeared to be complete with regard to recorded actions taken on matters before the respective bodies for deliberation and action.

## **HOLDING COMPANY AND AFFILIATES**

The Company is subject to the *Alabama Insurance Holding Company Regulatory Act*, as defined in ALA. CODE § 27-29-1 (1975). In connection therewith, the Company is registered with the

Alabama Department of Insurance as joint registrant of an Insurance Holding Company System. The Company is responsible for holding company registration and periodic filings in accordance with ALA. CODE § 27-29-4 (1975), and ALA. ADMIN. CODE 482-1-055 (1994).

Appropriate filings required under the Holding Company Act were made from time to time by the Company as registrant. The examination did not determine that any required disclosures were excluded from the Company's filings, except as noted under the caption *Monthly Billing Service Agreement*.

### **Dividends to Stockholders**

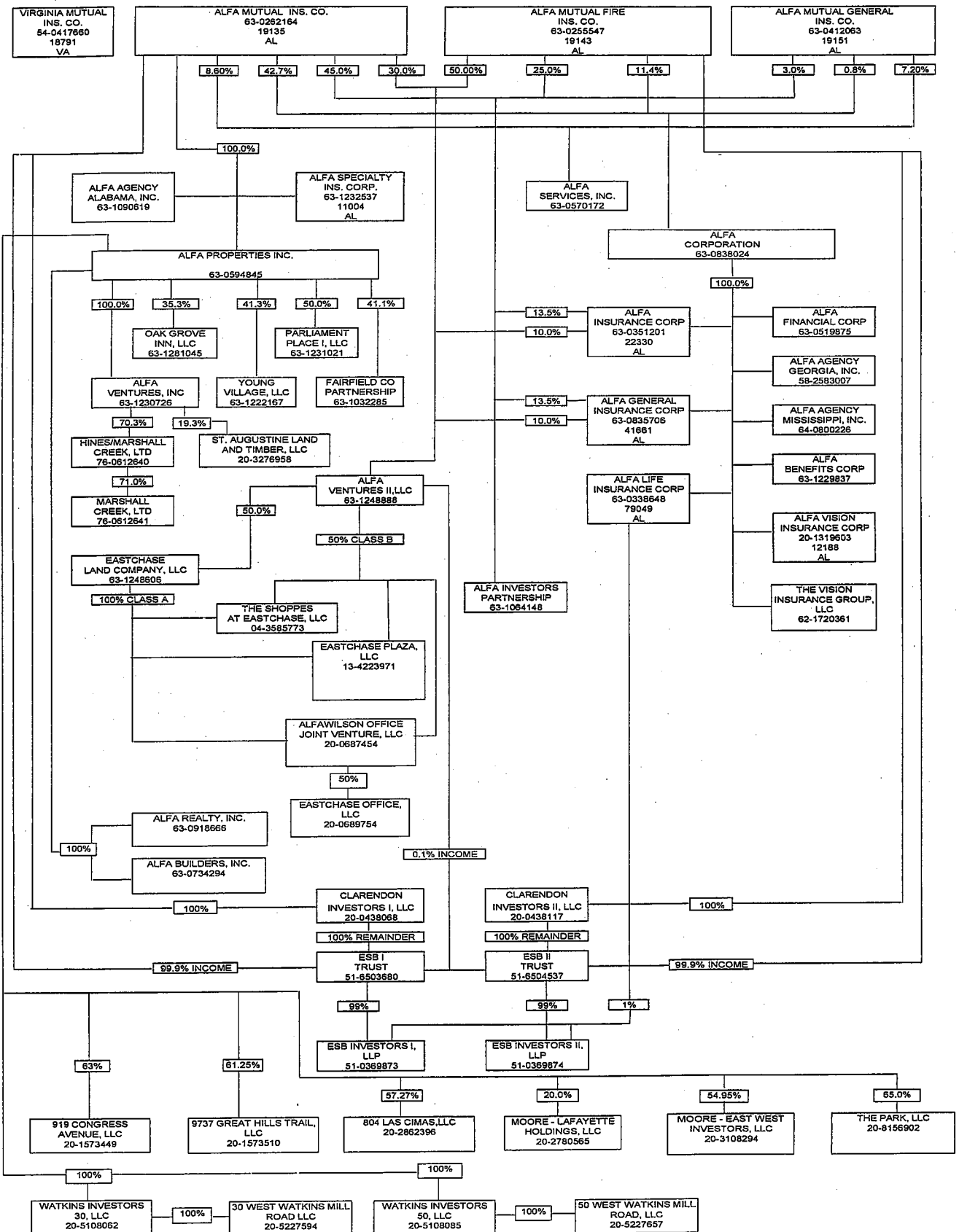
During the period under examination, the Company paid the following cash dividends to its sole stockholder, Alfa Corporation.

<u>Year</u>	<u>Dividend</u>
2002	\$ 6,913,500
2003	11,773,500
2004	14,442,000
2005	24,784,500
2006	24,810,500

Dividends paid were in accordance with Alabama statutes and regulations.

### **Organizational Chart**

The following Chart presents the identities and interrelationships among all affiliated persons within the Insurance Holding Company System at December 31, 2006.



## Transactions and Agreements with Affiliates

### *Management and Operating Agreement*

The following insurers were under the control of Alfa Mutual Insurance Company (AMI) and were parties to a Management and Operating Agreement with AMI: the Company, Alfa Mutual Fire Insurance Company; Alfa Mutual General Insurance Company; Alfa General Insurance Corporation; Alfa Specialty Insurance Corporation; Alfa Life Insurance Corporation; and, Alfa Vision Insurance Corporation. These companies will be referred to, collectively as the “affiliates” in the remainder of the discussion of this topic.

The original agreement had been in effect since January 1, 1960, with periodic amendments to modify the terms and to add companies as they became affiliated. Effective January 1, 2001, it was amended and restated “. . . in its entirety in order to clarify and make more certain their relationship to one another.” Also, the term of the agreement was to be five years, through December 31, 2005, then automatically renewed for periods of one year. Effective January 1, 2005, it was amended to include Alfa Vision Insurance Corporation.

Pertinent terms of the agreement include the following:

- The affiliates appoint and engage AMI to take charge of, conduct, operate and manage the business operations of the affiliates, respective to each affiliate’s charter and Board of Directors, and in a proper and prudent fashion. AMI will provide all home office operating service to the affiliates, including accounting, disbursement and payroll services and will serve as a disbursing agent for the payment of all employees and agents of the affiliates.
- AMI agrees to employ, in its own name, all personnel necessary to perform the aforesaid, and reserves all rights and responsibilities of the employer of said personnel. All agents of the affiliates shall be appointed in the name of the respective affiliates and shall work on behalf of the respective affiliates. All personnel and agents of any affiliate employed outside Alabama are the sole responsibility of that affiliate. AMI agrees to indemnify and hold the affiliates harmless against any loss on account of the dishonesty or infidelity of any of AMI’s employees. Also, the affiliates agree to indemnify and hold harmless AMI for liabilities and obligations prior to the effective date of the agreement, failure or negligent failure of the affiliate to perform under the agreement, breach of

warranty by the affiliate and liabilities or obligations of AMI's management or operation of the affiliate.

- AMI agrees that the business of each party to the agreement shall be conducted in the name of the respective party and that the records of each party shall be kept separately. AMI agrees to provide all required records, record-keeping services and data processing necessary to the efficient and economical operation of such business.
- The affiliates agree to reimburse AMI for expenses and additional charges in accordance with schedules which are attached to the agreement. These schedules are subject to periodic amendment. Expense allocations and other charges are determined by time, usage, and related special expense allocation studies conducted by AMI. Expenses entirely attributable to the affiliates such as printing and supplies are purchased and paid for directly by the respective affiliate.
- Arbitration: Disputes not resolved in 30 days are to be submitted for arbitration in the Birmingham, AL office of the American Arbitration Association in accordance with commercial arbitration rules.
- Confidentiality: Each party agrees to keep all Confidential Information strictly confidential.

Numerous expense categories are prorated between affiliates on Schedule A, an attachment to the agreement. Certain other expenses are allocated directly to the affiliates that benefit from expenditures. Agents' commissions are allocated 100% to the affiliate writing the business. Fixed monthly charges are paid by the affiliate for certain other expenses.

### ***Tax Allocation Agreement***

The Company entered into a Tax Allocation Agreement between Alfa Corporation, the Company's Parent, and among several affiliates including Alfa General Insurance Corporation, Alfa Vision Insurance Corporation, Alfa Financial Corporation, Alfa Builders, Inc., Alfa Realty, Inc., Alfa Agency Georgia, Inc., Alfa Agency Mississippi, Inc., Alfa Benefits Corporation and Alfa Life Insurance Corporation on January 1, 2004, that applied to the taxable year ending December 31, 2003, and subsequent years until terminated. The agreement was amended and restated effective March 1, 2004, to remove affiliates Alfa Builders, Inc. and Alfa Realty, Inc. from the affiliated group. The agreement was amended and restated again on May 22, 2006, to change

the tax allocation method to the percentage method pursuant to Treasury Regulation §1.1502-33(d)(3).

The Company and affiliates, parties to the agreement, agree as follows:

- A U.S. consolidated income tax return shall be filed by the Parent for the taxable year ending December 31, 2006, and for each subsequent taxable period in respect of which this agreement is in effect and for which the affiliated group is required or permitted to file a consolidated tax return.
- The agreement stipulates that the tax liability of the group shall be apportioned among the members of the group on the basis of the percentage of the total tax which the tax of such member is computed on a separate return would bear to the total amount of the taxes for all members of the group so computed.
- The tax liability of the group shall be apportioned under the percentage method consistent with the provisions of Regulation §1.1502-33(d)(3). This percentage method allocates tax liability based upon the absorption of tax attributes, without taking into account the ability of any member to subsequently absorb its own tax attributes.
- Payment of the consolidated tax liability for a taxable period shall include the payment of estimated tax installments due for such taxable period, and each subsidiary shall pay to the Parent its share of each payment within ten days of receiving notice of such payment. Any amounts paid by a subsidiary on account of a separate return or separate estimated tax payments which are credited against the consolidated tax liability of the Affiliated Group, shall be included in determining the payments due from such subsidiary. Any overpayment of estimated tax should be returned to the subsidiary.
- If the consolidated tax liability is adjusted for any taxable period, whether by means of an amended return, claim for refund, or after a tax audit by the IRS, the liability of each member shall be recomputed to give effect to such adjustments, and in the case of a refund, the Parent shall make payment to each member for its share of the refund, within ten days after the refund is received by the Parent. In the case of an increase in tax liability, each member shall pay to the Parent its allocable share of such increased liability within ten days after receiving notice of the liability from the Parent.

- If, during a consolidated return period, the Parent or any subsidiary acquires or organizes another corporation that is required to be included in the consolidated return, then such corporation shall join in and be bound by the agreement.
- The agreement shall be binding upon and inure to the benefit of any successor, whether by statutory merger, acquisition of assets or otherwise, to any of the parties, to the same extent as if the successor had been an original party to the agreement.

### ***Monthly Billing Service Agreement***

The Company entered into a Monthly Billing Service Agreement between Alfa Financial Corporation (Financial) and with: 1) Alfa Mutual Insurance Company, 2) Alfa Mutual General Insurance Company, 3) Alfa Mutual Fire Insurance Company, 4) Alfa Insurance Corporation, and 5) Alfa General Insurance Corporation (collectively referred to as "Insurers"). The agreement was effective January 1, 2005, and included the following:

- Financial agreed to grant a perpetual nontransferable license to use Financial's software in order to process transactions.
- Insurers will pay to Financial a non-refundable processing fee for the right to use Financial's software for processing monthly premium payment transactions.
- Financial will bear all credit losses.
- Financial shall be obligated to provide the software to Insurers without further charge or obligation and to provide Insurers any and all updates to said software.
- Insurers will remit to Financial the service fees no less frequently than on a monthly basis.
- The contract may be cancelled by either party by giving to the other party notice of cancellation in writing thirty days prior to the date cancellation is to become effective.
- In the event of cancellation, Insurers have no further right to use Financial's software, and Insurer's shall pay Financial through the date of cancellation.

- The contract will be governed by Alabama Law.
- The contract can only be amended in writing signed by all the parties.

A review of the aforementioned *Monthly Billing Service Agreement* and the holding company filings and amendments made on behalf of the Company indicated that the agreement had not been approved by the Alabama Department of Insurance. Because the Company had not obtained approval of the agreement among affiliates within the holding company system, the Company was not in compliance with ALA. CODE § 27-29-5 (b) (1975), which states:

“The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period. . . .

(4) All management agreements, service contracts, and all cost-sharing arrangements; and. . . .”

## **FIDELITY BOND AND OTHER INSURANCE**

At December 31, 2006, the Company was named insured under a financial institution bond issued by Fidelity and Deposit Company of Baltimore, Maryland. The single loss limit of the bond exceeded the NAIC suggested minimum requirements for fidelity coverage. The bond provided the following coverages:

- Fidelity
- Forgery or alteration
- Optional
  - Agents # 1
  - Computer systems fraud.

The Fidelity coverage insured the Company against any loss through any dishonest or fraudulent act committed by an employee acting alone or in collusion with others. The dishonest or fraudulent acts must be committed by the employee with the manifest intent to cause the insured to sustain such loss and to obtain financial benefit in the normal course of employment.

In addition to the fidelity bond, Alfa Mutual Insurance Company maintained other insurance policies to protect the Company and its affiliates against hazards to which they may be exposed.

## **EMPLOYEES' AND AGENTS' WELFARE**

The Company had no employees; therefore, it had no formal employees' or agents' welfare program. Its operations were conducted by the personnel of Alfa Mutual Insurance Company, an ultimate parent of the Company, under the terms of a Management and Operating Agreement. The Company's officers, elected and appointed, for the Company were also employees of Alfa Mutual Insurance Company. For further comment, see the caption *Management and Operating Agreement* under the heading HOLDING COMPANY AND AFFILIATES.

### **Section 1033 of Title 18 of the U.S. CODE**

As noted above, the Company's operations were conducted by personnel employed by Alfa Mutual Insurance Company (AMI) under the terms of a Management and Operating Agreement. According to ALA. ADMIN. CODE 482-1-121 (2003), persons who act as or are officers, directors, producers, or employees, including those authorized to act on their behalf are subject to Section 1033 of Title 18 of the U.S. CODE; therefore the Company and those acting on its behalf including Directors, officers, agents, and employees working under the terms of a Management and Operating Agreement are subject to the terms of the aforementioned ALA. ADMIN. CODE.

The Company was asked how it determined if those working on its behalf were not in conflict with Section 1033 of Title 18 of the U.S. CODE, and ALA. ADMIN. CODE 482-1-121 (2003), which prohibits certain persons from participating in the business of insurance.

The Company provided an employment application used during the examination period which asks potential employees about any criminal convictions during the previous ten years and the authorization to obtain consumer and/or investigative consumer reports on the applicant. Company management indicated that the Company does not hire applicants who have been convicted of a felony unless prior authorization has been obtained from the Alabama Department of Insurance in accordance with ALA. ADMIN. CODE 482-1-121 (2003). The Company's "Principles of Business Conduct" policy requires that employees report any felony

convictions, either personal or about another employee immediately to Human Resources.

Although, the employment applications used during the examination period, asked potential employees about felony convictions within the last ten years, and the "Principles of Business Conduct" (Principles) policy requires employees to report felony convictions, the Company could not demonstrate that employees who had been with the Company before the Principles went into effect were not in conflict with ALA. ADMIN. CODE 482-1-121 (2003), which states:

"... The Act contains no grandfather provision for persons already transacting the business of insurance. The Act contains no automatic waivers for individuals who may possess a state insurance license. Further, there is no time limitation on how far back the felony conviction that triggers the prohibited person status may have occurred. ..."

The Company indicated it had a procedure in place to perform background checks on agents and customer service representatives since 1998, and on its home office employees since 2004. The Company provided evidence that in 2003-2004 its employees electronically certified pursuant to the Company's Principles policy that they had not been convicted of a felony and would inform management of any changes to their responses. According to the Company, employees hired subsequent to 2004 signed the policy when hired and a copy is maintained in their personnel file.

The Company could not provide evidence that it has a policy in place to ensure those authorized to act on its behalf continue to meet the requirements of Section 1033 of Title 18 of the U.S. CODE, and ALA. ADMIN. CODE 482-1-121 (2003), which states:

"... Insurance companies, as well as persons employing anyone to conduct the business of insurance may be in violation of this statute if they willfully permit participation by a prohibited person, including persons who are already employed or being considered for employment. Failure to initiate a screening process in an attempt to identify prohibited persons in current or prospective employment relationships may be a factor in determining if a violation of this statute has occurred. ..."

## **SPECIAL DEPOSITS**

In order to comply with the statutory requirements for doing business in the various jurisdictions, in which it was licensed, the Company had the following securities on deposit with state authorities at December 31, 2006.

<u>State</u>	<u>Book Value</u>	<u>Fair Value</u>
Alabama	\$305,678	\$334,894
Florida	339,195	430,830
Georgia	88,713	112,679
Louisiana	26,092	33,141
New Mexico	199,625	202,796
<b>Total</b>	<b>\$959,303</b>	<b>\$1,114,340</b>

## **MARKET CONDUCT ACTIVITIES**

### **Territory**

At December 31, 2006, the Company was licensed to transact business in the following states:

Alabama	Louisiana	New Mexico	Texas
Florida	Mississippi	Oklahoma	Washington
Georgia	Nebraska	Tennessee	Wyoming
Indiana			

The Certificates of Authority from the respective jurisdictions were inspected and found to be in effect at December 31, 2006.

### **Plan of Operation**

During the period covered by the examination, direct writing operations of the Company were confined to the States of Georgia and Mississippi. At December 31, 2006, the Company's agency force consisted of 159 captive agents, operating from 85 service centers in Georgia and 73 services centers in Mississippi.

For the year 2006, about 69.70% of the direct premiums written were comprised of private passenger automobile insurance. Homeowner insurance comprised another 25.30% of the Company's direct written premiums. The remaining 5.00 % was

comprised by fire, allied lines, commercial multiple peril, inland marine, other commercial auto liability, and other liabilities.

The Company did not disclose any plans for acquisitions or expansion in the future.

### **Policy Forms and Underwriting**

All the Company's active policy forms and rates in force at December 31, 2006, were found to have been approved by the Alabama Department of Insurance, (ALDOI). Rates were filed independently on the Company's direct business.

### **Compliance with Agents' Licensing Requirements**

In order to verify compliance with agents' licensing requirements of the ALDOI, a sample of fifty agents licensed in Alabama was taken from the listing maintained by the Alfa Insurance Companies. The fifty items were compared with the listing maintained on the ALDOI website. No discrepancies were found within the sample.

A sample of 100 policies written by the Alfa Insurance Companies during the period covered by the examination was checked against the ALDOI's licensing records, to verify that the agents were appropriately licensed for the Alfa Insurance Companies. No discrepancies were found within the sample.

### **Advertising and Marketing**

The Company's advertising materials were reviewed for the period covered by the examination. The advertisements consisted of signs, billboards, newspaper advertisements and spot advertisements on radio and television.

The Company's web page ([www.alfains.com](http://www.alfains.com)) was reviewed and found to include the following links: Company's background, product lines, claim information, career opportunities, how to locate an agent or the Alabama Farmers Federation, headlines, and Company contact information.

The Company's advertising was planned and coordinated by Integrated Marketing Communication, a subdivision of the Alfa Mutual Insurance Company's marketing division. The cost of advertisement was shared on a proportionate basis with other participating affiliates of the Company and the Alabama Farmers Federation. Company management indicated that the producers were not allowed to create their

own advertising and sales material, including internet sites. Producers are required to use Company approved advertising material.

### **Claims Payments Practices**

The Company was audited with six other property and casualty insurance affiliates (P & C) and one Life Company. In order to verify compliance with claims payment practices of the Alabama Department of Insurance (ALDOI), a sample of 100 closed claims was taken from the P & C claims closed 2002 – 2006 register.

The paid claims sample was reviewed with regards to compliance with policy provisions, timeliness of payments, and adequacy of documentation. Other than the items listed below, no noteworthy discrepancies were found within the sample of paid claims. The examiners determined the following:

- Five files could not be located.
- Two claim payment drafts could not be located.

Since the Company could not provide the five files and the two claim payment drafts, the Company did not comply with ALA. CODE § 27-27-29 (a) (1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

The previous examination had also recommended that the Company comply with ALA. CODE § 27-27-29 (a) (1975), and keep complete and accurate records of its claims transactions.

### **Policyholders' Complaints**

The Company's complaint register was reviewed in order to verify if all written complaints were logged on the register. Company management indicated that complaints from insurance departments and written complaints received at the home office that allege violation of state or federal laws or of any regulations, directives, or bulletins of the insurance departments are logged on the register. There was one register for the seven Alfa P&C Companies combined, which included: 1) The Company, 2) Alfa Mutual Insurance Company, 3) Alfa Mutual General Insurance

Company, 4) Alfa Mutual Fire Insurance Company 5) Alfa General Insurance Corporation, 6)Alfa Specialty Insurance Corporation, and 7) Alfa Vision Insurance Corporation.

During the period covered by the examination, 233 complaints were logged on the register against the Alfa P & C Companies. The complaint register did not specify which company was the subject of the complaint. Fifty complaint files were requested to determine if the files contained adequate documentation. The examiners determined that the Alfa P & C Companies maintained adequate documentation.

The Alabama Department of Insurance adopted the NAIC Market Regulation Handbook, effective May 7, 2007, via ALA. ADMIN. CODE 482-1-097-.07 (2007). According to the handbook, regulated entity should include, but not be limited, to the following information in the complaint register:

- Line of business
- Function (underwriting, marketing and sales, claims, policyholder services or miscellaneous);
- Reason for complaint (underwriting, application, cancellation, rescission, non-renewal).

The handbook also requires that the regulated entity record all written communication expressing a grievance in the regulated entity's complaint register.

### **Privacy Policies and Practices**

The Company's policy is that non-public information involving underwriting, marketing, claims handling, and fraud prevention is not shared with anyone outside the Company, except for that sharing allowed by the exceptions in the Gramm-Leach-Bliley Act. The insured receives a Privacy Notice at the point-of-sale, and the Company sends a Privacy Notice to the insured on an annual basis. The Company complied with the privacy requirements of ALA. ADMIN. CODE 482-1-122 (2001).

## **FINANCIAL CONDITION/GROWTH OF THE COMPANY**

The following table sets forth the significant items indicating the growth and financial condition of the Company for the period under review:

<u>Year</u>	<u>Gross Premiums Written</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Policyholders' Surplus</u>
2001*	\$265,260,944	\$291,199,950	\$155,813,328	\$135,386,622
2002	288,146,534	314,289,274	167,151,842	147,137,433
2003	311,501,492	336,246,425	174,637,255	161,609,169
2004	336,238,603	410,703,162	231,614,672	179,088,489
2005	359,068,692	423,375,220	233,742,201	189,633,019
2006*	391,248,039	449,894,006	250,166,662	199,727,345

\*Per examination.

Amounts for the remaining years were obtained from Company copies of filed Annual Statements.

## REINSURANCE

### Intercompany Reinsurance Pooling Agreement

This agreement was originally effective August 1, 1987, between the Company and its affiliates: Alfa Mutual Insurance Company (AMI); Alfa Mutual Fire Insurance Company (AMF); Alfa Mutual General Insurance Company (AMG); and Alfa General Insurance Corporation (AGI). Alfa Specialty Insurance Corporation (ASI) was added to the pool in 2001. Alfa Vision Insurance Corporation (AVI) was added to the pool in 2005. These participants in the pooling agreement will be referred to as "the affiliates" for the remainder of this discussion. This reinsurance pooling agreement was filed with the Alabama Department of Insurance on July 29, 1987, and was subsequently approved. Pertinent terms of the agreement are as follows: The affiliates cede 100% of the net liabilities for net premiums written to AMI and AMI retains or retrocedes the pooled business in accordance with the following percentages:

Company	Effective January 1, 2001	Effective January 1, 2005
AMI	18	18
AMF	13	13
AMG	3	3
ASI	1	1
AIC	32.5	30
AGI	32.5	30
AVI	N/A	5
TOTAL	<u>100</u>	<u>100</u>

The following percentages are shown below for the Coinsurance Allocations for Catastrophe Losses and Related Expenses for the related years:

Effective January 1, 2002			Effective January 1, 2003		
Cumulative Calendar Year Catastrophe Losses and Related Expenses (Million)	Coinsurance Allocation		Cumulative Calendar Year Catastrophe Losses and Related Expenses (Million)	Coinsurance Allocation	
	AGI AIC	AMI, AMF AMG, ASI		AGI AIC	AMI, AMF AMG, ASI
11.6	65%	35%	12.125	65%	35%
19	0%	100%	19	0%	100%
32	0%	100%	32	0%	100%
43	0%	100%	43	0%	100%
77	0%	100%	77	0%	100%
146	0%	100%	146	0%	100%
198	0%	100%	198	0%	100%
289+	16%	84%	301.5	18%	82%

- Cumulative calendar year catastrophe losses and related expenses are in millions.
- AIC and AGI to be allocated equally.
- AMI, AMF, AMG, and ASI to be allocated according to this group's relative pool percentages in effect.
- Catastrophe losses are to be accumulated during each annual calendar period.
- AMI, AMF, AMG, ASI, AIC and AGI to be allocated according to this group's relative surplus.

Effective January 1, 2004		
Cumulative Calendar Year Catastrophe Losses and Related Expenses (Million)	Coinsurance Allocation	
	AGI AIC	AMI, AMF AMG, ASI
Less than or = 14.2	65%	35%
Between 14.2 - 352	0%	100%
Greater than or = 352	18%	82%

- AIC and AGI to be allocated equally.
- AMI, AMF, AMG, and ASI to be allocated according to this group's relative pool percentages in effect.
- Catastrophe losses are to be accumulated during each annual calendar period.
- AMI, AMF, AMG, ASI, AIC and AGI to be allocated according to this group's relative surplus.

Effective January 1, 2005			Effective January 1, 2006		
Cumulative Calendar Year Catastrophe Losses and Related Expenses (Million)	Coinsurance Allocation		Cumulative Calendar Year Catastrophe Losses and Related Expenses (Million)	Coinsurance Allocation	
	AGI, AVI, AIC	AMI, AMF, AMG, ASI		AGI, AVI, AIC	AMI, AMF, AMG, ASI
Less than or = 17.9	65%	35%	Less than or = 21.2	65%	35%
Between 17.9 – 443.7	0%	100%	Between 21.2 – 525.5	0%	100%
Greater than or = 443.7	19%	81%	Greater than or = 525.5	21%	79%

- AMI, AMF, AMG, ASI, AIC, AGI and AVI to be allocated according to this group's relative pool percentages in effect.
- Catastrophe losses are to be accumulated during each annual calendar period.
- AMI, AMF, AMG, ASI, AIC, AGI and AVI to be allocated according to this group's relative surplus as reported in the preceding year-end annual statement.
- Effective January 1, 2006 - Coinsurance Allocation of AMI to include any coinsurance allocation for ASI (AMI's wholly owned subsidiary).

### **Reinsurance Assumed**

*Schedule F – Part 1* of the Company's 2006 Annual Statement reported assumed reinsurance premiums from Georgia Underwriting Association and Mississippi Underwriting Association. Reinsurance assumed from Georgia Workers' Compensation and Mississippi Workers' Compensation was in run-off.

### **Reinsurance Ceded**

As of December 31, 2006, the Company ceded reinsurance to an affiliate, Alfa Mutual Fire Insurance Company (AMF) via three Intercompany Traditional Excess Catastrophe Reinsurance contracts:

- 1) Intercompany Traditional Excess Catastrophe Reinsurance Contract, effective January 1, 2006, whereby the Company cedes 100% of the First and Second Excess Catastrophe Reinsurance as follows:

Description	First Excess	Second Excess
Company's Retention	\$75,000,000	\$125,000,000
Participation Rate:	0%	0%
Reinsurer's Per Occurrence Limit (100% of)	\$50,000,000	\$75,000,000
Reinsurer's Term Limit (100% of)	\$100,000,000	\$150,000,000

- 2) Intercompany Traditional Excess Catastrophe Reinsurance Contract, effective June 1, 2006, whereby the Company cedes 100% of the Third, Fourth, Fifth, Sixth A and Sixth B Excess Catastrophe Reinsurance, subject to the following:

	Third Excess	Fourth Excess	Fifth Excess	Sixth A Excess	Sixth B Excess
Company's Retention	\$200,000,000	\$300,000,000	\$400,000,000	\$500,000,000	\$525,500,000
Intercompany Placement %	72.25%	96.3%	85.925%	79.555%	79.555%
Participant Rate:	0%	0%	0%	0%	9.8%
Reinsurer's Per Occurrence Limit (100% of)	\$100,000,000	\$100,000,000	\$100,000,000	\$25,500,000	\$174,500,000
Reinsurer's Term Limit (100% of)	\$200,000,000	\$200,000,000	\$200,000,000	\$51,000,000	\$349,000,000

- 3) Intercompany Traditional Excess Catastrophe Reinsurance Contract, effective June 15, 2006, whereby the Company ceded 100% of the Seventh Excess Catastrophe Reinsurance. The Company's pool participation rate for this layer is 9.8%. The Reinsurer's retention is the first \$700,000,000 of ultimate net loss per occurrence, with a term limit of 80.5% of \$100,000,000.

As of December 31, 2006, the following contracts for ceding reinsurance to non-affiliated companies were applicable to the Company:

**General Reinsurance Corporation**

- Excess of Loss Reinsurance (9138) – effective April 1, 2004, on property business. The Company's retention for the first excess cover was \$500,000 and the second excess cover was \$1,000,000. The limit of liability of the reinsurer will not exceed a total payment of net loss and adjustment expense combined under the first excess cover of \$1,500,000 or under the second excess of \$3,000,000 all risks involved in once occurrence. This agreement also included excess of loss reinsurance of liability business. The Company's retention was \$500,000 for the first excess cover and \$1,000,000 for the second excess cover. Effective July 1, 2006, the Company's retention for the first excess cover increased to \$750,000 and a third excess cover in the amount of \$2,000,000 for new and renewal policies becoming effective at and after October 1, 2006 was added.
- Quota Share and Excess of Loss Reinsurance of Personal Umbrella Business (B762-03) – effective August 1, 2003, on automobile liability, licensed recreational vehicles, uninsured/underinsured motorists' coverages, business pursuits,

employers' liability, personal liability and unlicensed recreational vehicles and watercraft liability. AIC's retention is 5% of the first \$1 million, each occurrence. The limit of liability of the Company with respect to any one policy shall be deemed not to exceed \$2,000,000 for youthful operators and \$5,000,000 as respects all other policies, each occurrence.

- Quota Share and Excess of Loss Reinsurance of Farm Personal Umbrella Business (B762-03) – effective August 1, 2003, on automobile liability, licensed recreational vehicles, uninsured/underinsured motorists' coverages, business pursuits, employers' liability, farm liability, personal liability and unlicensed recreational vehicles and watercraft liability. AIC's retention is 5% of the first \$1 million, each occurrence. The limit of liability of the Company with respect to any one policy shall be deemed not to exceed \$2,000,000 for youthful operators and \$5,000,000 as respects all other policies, each occurrence.
- Quota Share and Excess of Loss Reinsurance of Commercial Umbrella Business (B762-03) – effective August 1, 2003, on commercial general liability, comprehensive automobile liability including hired and non-owned auto coverage and uninsured/underinsured motorists' coverages, watercraft liability, employers' liability, and professional liability. AIC's retention is 5% of the first \$1 million, each occurrence. The limit of liability of the Company with respect to any one policy shall be deemed not to exceed \$5,000,000 each occurrence / \$5,000,000 aggregate (where applicable).
- Property Facultative Binding Agreement (174), effective December 1, 2003, on fire, allied lines, inland marine or commercial multiple peril and church risks in Alabama, Georgia or Mississippi. The Company's retention was \$2,500,000 and the maximum amount of reinsurance was \$8,000,000 as of 12/31/06.

## ACCOUNTS AND RECORDS

The Company's principal accounting records were maintained on electronic data processing equipment. Management and record-keeping functions were performed by the personnel of Alfa Mutual Insurance Company under a Management and Operating Agreement. For further review of the agreement, see the caption *Management and Operating Agreement* under the heading HOLDING COMPANY AND AFFILIATES.

The examiners reviewed the accounts and records maintained by the Company for its cash disbursements of \$25.00 or more. The review indicated the Company's documentation for intercompany balance transfers was not in compliance with ALA. CODE § 27-27-30 (1975). The Company provided copies of the cancelled checks, and vouchers which included the amount of transfer, the payor, and payee.

The documentation did not include a description of the consideration for the payment, a description of the services provided, itemization of the expenditures, or a receipt. The documentation is required by ALA. CODE § 27-27-30 (1975), which states:

“(a) No insurer shall make any disbursement of \$25.00 or more unless evidenced by a voucher or other document correctly describing the consideration for the payment and support by a check or receipt endorsed or signed by, or on behalf of, the person receiving the money.

(b) If the disbursement is for services and reimbursement, the voucher or other document, or some other writing referred to therein, shall describe the services and itemize the expenditures. . . .”

### **Internal Accounting Records**

The Company's internal controls and information systems are those of AMI, since the Company is operated by AMI, in accordance with the aforementioned Management and Operating Agreement. Said internal controls and information systems were reviewed during the concurrent examination of AMI. They were evaluated by observation, interviewing AMI personnel, and reviewing the NAIC Internal Controls and Information Systems Questionnaires and Examiner Planning Questionnaire completed by AMI. AMI's internal controls and information system controls appeared to be sufficient to safeguard the Company's assets and to generate adequate records of its business. The Company's accounting systems and documentation of its transactions were deemed adequate.

### **External Audit and Actuarial**

The Company and its affiliates were audited annually, on a statutory basis. In 2006, the Company and its affiliates were audited by the certified public accounting (CPA) firm of PriceWaterhouseCoopers (PwC), Birmingham, AL; and annually in 2002-2005 by KPMG, Birmingham, AL. The audit reports and workpapers of the external auditors were made available to the examiners, and were utilized as deemed appropriate.

The Company's reserves were certified as of December 31, 2002, 2003, 2004, and 2005, by Mr. Scott Weinstein, FCAS, MAAA, of KPMG, LLC. The Company's reserves were certified as of December 31, 2006, by Mr. Anthony Kellner, FCAS, MAAA, of (PwC).

### **Record Retention Policy**

The Company's Record Retention Policy stated that the Company maintains its records as required by law and as long as the records were useful to the Company. Company management also indicated that each department within the Company is responsible for developing a record retention schedule that meets the specific needs of the department. The examination determined that the Company's record retention policy did not contain specific language as to the actual length or time the records are to be retained in accordance with ALA. ADMIN. CODE 482-1-118-.03 (1999), which states:

“Every insurer, which term shall include every domestic insurer . . . or any other legal entity regulated by the Insurance Code and licensed to do business in this state shall maintain its books, records, documents and other business records in order that the insurer's financial condition may be readily ascertained by the Department of Insurance, taking into consideration other record retention requirements. All records must be maintained for not less than five (5) years.”

### **Disaster Recovery Plan**

The NAIC Information System Questionnaire (ISQ) assisted the examiners in determining the strengths and weaknesses within the Company's IS Department. Based on a review of the ISQ responses and supporting documentation, it was determined the business continuity plan describes senior management's roles and responsibilities associated with the declaration of an emergency and implementation of the disaster recovery and business continuity plans.

The Company provided a copy of its Disaster Recovery Plan and documentation supporting its testing. The Company's ISQ responses, Disaster Recovery Plan and supporting documentation were reviewed and it was determined the Company has an adequate and up-to-date plan in place. The plan is reviewed quarterly, and tested annually at an alternate site.

### **Consideration of Fraud**

The examiners utilized the procedures recommended in the NAIC Financial Condition Examiners Handbook in Exhibit M – Consideration of Fraud. The CPA documentations on the fraud risk factors were reviewed and procedures were included during the examination to test the risk factors identified during the planning stages of the examination. Company management was interviewed; management

showed an understanding of the fraud risk factors in the Company and has taken action over the years to mitigate the risk.

## **FINANCIAL STATEMENTS**

The Financial Statements included in this report were prepared based on the Company's records, and the valuations and determinations made during the examination for the year ended December 31, 2006. Amounts shown in the comparative statements for the years 2002, 2003, 2004, 2005 were compiled from Company copies of filed Annual Statements. The statements are presented in the following order:

Statement of Assets, Liabilities, Surplus	31 and 32
Summary of Operations	33
Capital and Surplus	34

**THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN  
THIS REPORT ARE AN INTEGRAL PART THEREOF.**

**ALFA INSURANCE CORPORATION**  
**STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS**

**For the Year Ended December 31, 2006**

	Assets	Non-admitted Assets	Net Admitted Assets
<b><u>ASSETS</u></b>			
Bonds	\$300,434,810	\$ 0	\$300,434,810
Stocks:			
Preferred Stock	3,221,400		3,221,400
Common Stock	9,651,343		9,651,343
Cash, cash equivalents, and short-term investments (Note 1)	19,188,229	0	19,188,229
Other invested assets	42,695,421		42,695,421
Receivables for securities	1,922,304		1,922,304
Aggregate write-ins for invested assets	(4)	0	(4)
Subtotals, cash and invested assets	\$377,113,502	\$ 0	\$377,113,502
Investment income due and accrued	3,459,259	0	3,459,259
Premiums and considerations: Uncollected premiums and agents' balances in the course of collection (Note 2)	17,400,408	55,984	17,344,424
Deferred premiums, agents' balances and installments booked but deferred and not yet due (Note 2)	33,064,991	11,602	33,053,389
Reinsurance: Amounts recoverable from reinsurers	5,396,316	0	5,396,316
Current federal and foreign income tax recoverable and interest thereon	1,987,535	0	1,987,535
Net deferred tax asset	12,864,973	3,973,501	8,891,472
Electronic data processing equipment and software	18,628	18,628	
Receivables from parent, subsidiaries and affiliates	2,648,109	0	2,648,109
Health care and other amounts receivable	5,596	5,596	0
Aggregate write-ins for other than invested assets	476,815	476,815	0
<b>Total Assets</b>	<b><u>\$454,436,133</u></b>	<b><u>\$4,542,126</u></b>	<b><u>\$449,894,007</u></b>

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN  
THIS REPORT ARE AN INTEGRAL PART THEREOF.

**ALFA INSURANCE CORPORATION**  
**STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS**

For the Year Ended December 31, 2006

<b><u>Liabilities:</u></b>	
Losses	\$73,154,738
Reinsurance payable on paid losses and loss adjustment expenses	13,397,006
Loss adjustment expenses	12,955,265
Other expenses (excluding taxes, licenses, and fees)	160,039
Taxes, licenses, and fees (excluding federal and foreign income taxes)	1,957,430
Unearned premiums	92,286,845
Advance premium	16,222,074
Ceded reinsurance premiums payable (net of ceding commissions)	3,165,198
Amounts withheld or retained by the Company for the account of others	9,911,371
Remittances and items not allocated	330,942
Drafts outstanding	6,005,815
Payable to parent, subsidiaries, and affiliates	1,169,152
Payable for securities	310,760
Aggregate write-ins for liabilities	<u>19,140,027</u>
<b>Total Liabilities</b>	<b><u>\$250,166,662</u></b>
<b><u>Capital and Surplus:</u></b>	
Aggregate write-ins for special surplus	3,775,279
Common capital stock	1,500,000
Gross paid in and contributed surplus	32,447,957
Unassigned funds	<u>162,004,109</u>
<b>Total Capital and Surplus</b>	<b><u>\$199,727,345</u></b>
<b>Total Liabilities and Stockholders' Equity</b>	<b><u>\$449,894,007</u></b>

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN  
THIS REPORT ARE AN INTEGRAL PART THEREOF.

**ALFA INSURANCE CORPORATION**  
**SUMMARY OF OPERATIONS**

**For the Years Ended December 31, 2006, 2005, 2004, 2003, and 2002**

	2006	2005	2004	2003	2002
<b>Underwriting Income</b>					
Premiums earned	\$278,876,630	\$256,821,878	\$242,767,296	\$227,221,747	\$211,672,067
Losses incurred	161,757,189	154,117,445	149,365,726	142,139,723	135,199,525
Loss expenses incurred	13,889,030	11,077,527	10,196,854	8,967,608	9,278,039
Other underwriting expenses incurred	79,701,503	67,542,140	59,248,083	60,188,586	55,265,437
Aggregate write-ins for underwriting deductions	<u>(565)</u>	<u>(5,748)</u>	<u>(61,952)</u>	<u>(138,384)</u>	<u>(182,489)</u>
Total underwriting deductions	<u>\$255,357,157</u>	<u>\$232,731,364</u>	<u>\$218,748,711</u>	<u>\$211,157,533</u>	<u>\$199,560,512</u>
Net underwriting gain / (loss)	\$23,519,473	\$24,090,514	\$24,018,585	\$16,064,214	\$12,111,555
<b>Investment Income</b>					
Net investment income earned	15,284,032	18,432,863	16,298,298	14,592,915	18,041,409
Net realized capital gains/(loss)	<u>92,303</u>	<u>(738,904)</u>	<u>(1,598,780)</u>	<u>(1,251,717)</u>	<u>(91,182)</u>
Net investment gain/(loss)	\$15,376,335	\$17,693,959	\$14,699,518	\$13,341,198	\$17,950,227
<b>Other Income</b>					
Net gain / (loss) from agents' or premium balances charged off	(615,499)	(107,394)	(113,192)	0	0
Finance and service charges not included in premiums	6,543,950	4,664,057	3,058,641	2,958,591	2,823,978
Aggregate write-ins for miscellaneous income	<u>766</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>17</u>
Total other income	\$5,929,217	\$4,556,663	\$2,945,449	\$2,958,591	\$2,823,995
Net income, after dividends to policyholders, after capital gains tax and before all federal and foreign income tax	44,825,025	46,341,136	41,663,552	32,364,003	32,885,777
Federal and foreign income taxes incurred	<u>10,257,404</u>	<u>13,891,155</u>	<u>12,873,028</u>	<u>9,522,793</u>	<u>8,725,874</u>
<b>Net Income</b>	<u><b>\$34,567,621</b></u>	<u><b>\$32,449,981</b></u>	<u><b>\$28,790,524</b></u>	<u><b>\$22,841,210</b></u>	<u><b>\$24,159,903</b></u>

**THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN THIS REPORT ARE AN INTEGRAL PART THEREOF.**

**ALFA INSURANCE CORPORATION  
CAPITAL AND SURPLUS ACCOUNT**

**For the Years Ended December 31, 2006, 2005, 2004, 2003, and 2002**

	2006	2005	2004	2003	2002
Surplus as regards policyholders, December 31 prior year	\$189,633,019	\$179,088,489	\$161,609,169	\$147,137,433	\$135,386,624
Net income	34,567,621	32,449,981	28,790,524	22,841,210	24,159,903
Change in net unrealized capital gains or (losses)	95,883	425,692	(58,202)	2,538,702	(3,713,118)
Change in net deferred income tax	1,735,357	1,398,096	2,169,791	(404,567)	963,398
Change in non-admitted assets	(1,474,919)	(719,231)	1,019,207	1,259,120	(4,384,927)
Change in provision for reinsurance	0	0	0	0	1,204
Cumulative effect of changes in accounting principles	(110,011)	0	0	0	1,381,709
Dividends to stockholders	(24,810,500)	(24,784,500)	(14,442,000)	(11,773,500)	(6,913,500)
Aggregate write-ins for gains and losses in surplus	<u>90,894</u>	<u>1,774,492</u>	<u>0</u>	<u>10,771</u>	<u>256,140</u>
<b>Change in surplus as regards policyholders for the year</b>	<b><u>\$10,094,325</u></b>	<b><u>\$10,544,530</u></b>	<b><u>\$17,479,320</u></b>	<b><u>\$14,471,736</u></b>	<b><u>\$11,750,809</u></b>
<b>Surplus as regards policyholders, December 31 current year</b>	<b><u>\$199,727,344</u></b>	<b><u>\$189,633,019</u></b>	<b><u>\$179,088,489</u></b>	<b><u>\$161,609,169</u></b>	<b><u>\$147,137,433</u></b>

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN  
THIS REPORT ARE AN INTEGRAL PART THEREOF.

## NOTES TO FINANCIAL STATEMENTS

### Note 1 - Cash, cash equivalents and short-term investments

\$19,188,229

The captioned amount is the same as reported by the Company in its 2006 Annual Statement.

The examiners reviewed a sample of checks and drafts issued by the Company, for the payment of claims, from the January 2007 bank statement. The cut-off date was reviewed and it was determined that draft number 1710, dated December 30, 2006, for \$983, was not listed on the December 31, 2006, bank reconciliation outstanding check/draft listing. The Company must record all transactions, including drafts not presented for payment, in the month the draft was issued on the outstanding listing, especially when accounting for draft disbursements under the "Draft Issued Method." The guidance provided by SSAP No. 2, paragraph 8 of the NAIC Accounting Practices and Procedures Manual states:

"Draft Issued Method – When a draft is issued, an increase in paid losses and a related decrease in loss reserves is recorded. Drafts that have not been presented for payment and remain outstanding at the balance sheet date are reflected as a liability."

### Note 2 – Uncollected Premiums and agents' balances in the course of collection

\$17,344,424

#### Deferred premiums, agents' balances and

#### installments booked but deferred and not yet due

\$33,053,389

The captioned \$17,344,424 is the same as reported by the Company in its 2006 Annual Statement, but \$1,903,612 less than that determined by the examination. The captioned \$33,053,389 is the same as reported by the Company in its 2006 Annual Statement, but \$1,903,612 more than that determined by the examination.

The examination determined that the Company recorded certain premiums due under *Deferred premiums, agents' balances and installments booked but deferred and not yet due*. Premiums due are recorded under *Uncollected premiums and agents' balances in the course of collection*, in accordance with the guidance provided by the NAIC Annual Statement Instructions, which state:

"Line 13.1 – Uncollected premiums and Agents' Balances in Course of Collection.

Include: Direct and group billed uncollected premiums. Amounts collected but not yet remitted to home office.”

## **CONTINGENT LIABILITIES AND PENDING LITIGATION**

The examination for contingent liabilities and pending litigation included review of the Company’s Annual Statement disclosures, minutes of the corporate governing bodies, pending claims, and the usual examination of the accounts for unrecorded items. No unreported contingent liabilities were noted and all litigation pending against the Company, at December 31, 2006, appeared to be within the ordinary course of its business.

The Company’s Chief Executive Officer and its Chief Financial Officer executed a letter of representation, attesting to the non-existence of unreported liabilities and contingencies as of December 31, 2006.

## **COMPLIANCE WITH PREVIOUS RECOMMENDATIONS**

A review was conducted during the current examination with regards to the Company’s compliance with recommendations made in the previous examination report. This review indicated that the Company had satisfactorily complied with the recommendations contained in the immediately preceding Report on Examination with the exception of the item listed below.

### **Claims Payment and Practices**

The previous examination had noted that the Company did not provide five claims files out of forty-seven files taken from the closed and closed without payment listing, and recommended that the Company comply with ALA. CODE § 27-27-29 (a) (1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

The Company did not comply with the recommendation made in the prior Report on Examination. See the caption Claims Payments Practices under the heading MARKET CONDUCT ACTIVITIES.

## **COMMENTS AND RECOMMENDATIONS**

### **Conflict of Interest – Page 7**

It is recommended that the Company maintain evidence of its conflict of interest statements signed by each officer, director and other key personnel as required by the Company's "Principles of Business Conduct" policy and the GENERAL INTERROGATORIES of the NAIC Annual Statement Instructions.

### **Monthly Billing Service Agreement – Page 14**

It is recommended that the Company file all related parties' contracts with the commissioner for approval before entering into transactions under the contract and comply with ALA. CODE § 27-29-5 (b) (1975), which states:

"The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period. . . .

(4) All management agreements, service contracts, and all cost-sharing arrangements; and. . . ."

### **Section 1033 of Title 18 of the U.S. CODE – Page 16**

It is recommended that the Company create a policy that ensures those authorized to act on its behalf continue to meet the requirements of Section 1033 of Title 18 of the U.S. CODE, and ALA. ADMIN. CODE 482-1-121 (2003), which states:

"... Insurance companies, as well as persons employing anyone to conduct the business of insurance may be in violation of this statute if they willfully permit participation by a prohibited person, including persons who are already employed or being considered for employment. Failure to initiate a screening

process in an attempt to identify prohibited persons in current or prospective employment relationships may be a factor in determining if a violation of this statute has occurred. . . .”

### **Claims Payments Practices – Page 20**

**It is recommended** that the Company maintain complete records of closed claims, including the five missing files, in accordance with ALA. CODE § 27-27-29 (a) (1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

### **Policyholders’ Complaints - Page 20**

**It is recommended** that the Company record all written communication primarily expressing a grievance in the company’s complaint register. The recommendation is effective May 7, 2007, when the Alabama Department of Insurance adopted the NAIC Market Regulation Handbook.

**It is recommended** that the company log the function and reasons for complaints in its complaint register. The recommendation is effective May 7, 2007, when the Alabama Department of Insurance adopted the NAIC Market Regulation Handbook.

### **Accounts and Records – Page 26**

**It is recommended** that the Company maintain the required supporting documentation for all disbursements exceeding \$25.00, including intercompany balance transfers, in accordance with ALA. CODE § 27-27-30 (1975), which states:

“(a) No insurer shall make any disbursement of \$25.00 or more unless evidenced by a voucher or other document correctly describing the consideration for the payment and support by a check or receipt endorsed or signed by, or on behalf of, the person receiving the money.

(b) If the disbursement is for services and reimbursement, the voucher or other document, or some other writing referred to therein, shall describe the services and itemize the expenditures. . . .”

#### **Record Retention Policy – Page 28**

**It is recommended** that the Company’s record retention policy indicate that all records should be maintained for no less than five years in accordance with ALA. ADMIN. CODE 482-1-118-.03 (1999), which states:

“Every insurer, which term shall include every domestic insurer . . . or any other legal entity regulated by the Insurance Code and licensed to do business in this state shall maintain its books, records, documents and other business records in order that the insurer’s financial condition may be readily ascertained by the Department of Insurance, taking into consideration other record retention requirements. All records must be maintained for not less than five (5) years.”

#### **Cash and short-term investments - Page 35**

**It is recommended** that the Company record all transactions, including drafts not presented for payment, in the month the draft was issued on the outstanding listing in accordance with the guidance provided by SSAP No. 2, paragraph 8 of the NAIC Accounting Practices and Procedures Manual, which states:

“Draft Issued Method – When a draft is issued, an increase in paid losses and a related decrease in loss reserves is recorded. Drafts that have not been presented for payment and remain outstanding at the balance sheet date are reflected as a liability.”

#### **Uncollected premiums and agents’ balances in the course of collection – Page 35**

#### **Deferred Premiums, agents’ balances and installments booked but deferred and not yet due – Page 35**

**It is recommended** that the Company record all due and uncollected premiums on *Uncollected premiums and agents’ balances in the course of collection* in accordance with the guidance provided by the NAIC Annual Statement Instructions, which state:

“Line 13.1 – Uncollected premiums and Agents’ Balances in Course of Collection.

Include: Direct and group billed uncollected premiums. Amounts collected but not yet remitted to home office.”

## **SUBSEQUENT EVENTS**

The review of events subsequent to December 31, 2006, and up to the date of this report included: review of the March 31, 2007, June 30, 2007, and September 30, 2007, Quarterly Statements; 2) review of the December 31, 2007 Annual Statement; and 3) general review of the cash disbursements/receipts transactions that might potentially have a material impact on the Company’s continued operations and/or financial conditions. In addition, the examiners inquired of management regarding any significant subsequent events. There were no significant subsequent events other than those discussed below.

### **Privatization of Alfa Corporation**

On April 15, 2008, Alfa Mutual Insurance Company (AMI) and Alfa Mutual Fire Insurance Company (AMF) completed a merger transaction (the Merger) in which they acquired the shares of Alfa Corporation (AC) not previously owned by them. As a result of the transaction, AC became a wholly owned subsidiary of AMI (65%) and AMF (35%). Each share of common stock of AC (other than shares owned by AMI, AMF, AC, and its wholly owned subsidiaries, and holders of shares subject to certain company awards) was cancelled and converted into the right to receive \$22.00 in cash, without interest.

Also, as a result of the Merger, AC’s common stock ceased to trade on the Nasdaq Global Select Market as of the close of trading on April 15, 2008, and the registration of AC’s common stock under the Securities Exchange Act of 1934, as amended, was terminated.

### **Contingencies**

Subsequent to the end of the second quarter 2007, and following the initial announcement of the proposed Merger, certain purported class action lawsuits were brought on behalf of the public stockholders of AC in the Delaware Court of Chancery and in the Circuit Court of Montgomery County, Alabama. On April 14,

2008, the Circuit Court of Montgomery County, Alabama, formally approved the settlement reached by the parties to the aforementioned class action lawsuits.

In addition, on November 9, 2007, a policyholder of AMI filed a purported class action against AMI in the Circuit Court of Macon County, Alabama, also relating to the Merger. The policyholder subsequently elected to dismiss the class action claims. Also, on November 21, 2007, certain policyholders of AMI, AMF, and AMG filed a purported class action and derivative action against AMI, AMF, AMG, AC, and certain of their officers and directors in the Circuit Court of Walker County, Alabama. On February 23, 2008, counsel for the parties in the Walker County action entered into a Memorandum of Understanding to settle such action, subject to approval of the court. On March 4, 2008, the Walker County court conditionally approved the settlement and set a final approval hearing for May 28, 2008.

### **Pooling Agreement**

On January 1, 2007, the pooling agreement was amended to add Alfa Alliance Insurance Corporation (AAI). Effective April 16, 2008, the pooling agreement was amended to change the pool participation percentages.

## CONCLUSION

In concluding this Report on Examination, as of December 31, 2006, of *ALFA INSURANCE CORPORATION*, acknowledgment is hereby made of the courtesy and cooperation extended by all persons representing the Company during the course of the examination.

The customary examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed to the extent appropriate in connection with the verification and valuation of assets and the determination of liabilities set forth in this report.

In addition to the undersigned, Charles Turner, Toni Bean, Jennifer Haskell, Mora Perkins, Theo Goodin, Jerry Hyche, Examiners, Frank Fricks, CFE, AIE, with Insurance Logic and Matthew Merlino, FCAS, MAAA, FCA and Suejeudi Buehler, FCAS, MAAA, Consulting Actuarial Examiners, both with Merlino & Associates, Inc.; all representing the Alabama Department of Insurance, participated in this examination of Alfa Insurance Corporation.

Respectfully submitted,



Blase Francis Abreo, CFE  
Examiner-in-Charge  
State of Alabama  
Department of Insurance